CAN Europe input to the consultation on **draft ETS State Aid Guidelines**

Climate Action Network (CAN) Europe *is Europe's leading NGO coalition fighting dangerous climate change. With over 160 member organisations from 35 European countries, representing over 1.700 NGOs and more than 40 million citizens, CAN Europe promotes sustainable climate, energy and development policies throughout Europe.*

Introduction and principles

- The introduction should make references to the EU's commitment towards the objectives of the Paris Agreement, particularly the goal of limiting temperature increase to 1.5°C
- Based on recent science and the equity principles that underpin the Paris Agreement, CAN Europe is calling on the European Union to:
  - reduce its greenhouse gas emissions to net zero by 2040, and increase its NDC to at least 65% GHG emission reductions by 2030 (wording to be added in para. 7 of the draft guidelines around/ instead of "deliver additional GHG emissions reductions for 2030");
  - phase out all coal power plants by 2030 and ensure indirect cost compensations do not extend the lifetime of coal power plants;
  - source 100% of all energy from renewable sources by 2040;
  - phase out the use of all fossil fuels by 2040;
  - phase out all fossil fuel subsidies by 2020;
  - earmark at least 40% of the next EU budget for climate action;
  - dedicate 50% of future funding for neighbourhood development and development cooperation towards climate action and ensure a balance between support for adaptation and mitigation;
- CAN Europe rejects blanketed pollution subsidies and supports a move to 100% auctioning of ETS allowances
- There is a clear lack of evidence that EU climate policy triggers carbon leakage; low carbon pricing associated with multiple, cumulative exemptions for electro-intensive industries already permitted by the EEAG (on the same ground that there is a risk of carbon leakage) already greatly reduce that risk and undermine the need for continuous compensation for indirect emissions costs.
- There thus remains a lack of clear evidence to prove that this scheme is indeed necessary and an efficient use of taxpayer money.

- Even more worrying is the assertion in the explanatory note accompanying the draft guidelines that the Commission is still working on an impact assessment on options to be used in the final guidelines.This assessment should have been completed before the draft guidelines were published to ensure policy makers and stakeholders were informed as much as possible.
- The emission factors / calculations proposed seem to focus only on the supply side, not energy conservation measures. No differentiation is made on non-combustion type renewables or fuel mix. More generally the emission factor takes a shortsighted approach because only referring to GHG, not other externalities (e.g. air pollution, resource consumption). Applying the "common interest" test as well as "best value for money" criteria in a coherent manner requires those other aspects to be considered as well.
- More generally the current proposal lacks any link to compliance with "Union Standards" and wider environmental protection goals, which is a major shortcoming in contradiction to the declared European Green Deal goals
- Finally, financial aid is one of the means to deliver a certain outcome, decision making authorities, be it at EU or national level, should first be required to assess other policy options to achieve a certain change of behaviour of economic actors prior to considering "corrective" compensation aid schemes to certain economic actors as exclusively proposed by this aid scheme, in most cases benefitting the high polluting ones[1]

Scope and definitions

- Para. 9 prohibiting aid to firms in difficulty is welcome. This was not expressly provided in the former version of the ETS guidelines and some Member States attempted to use this loophole to grant free allowances to (coal) plants in financial difficulties.

CO_2 emission factor

- Para. 10 is a step backwards in the Commission's practice and is giving the opportunity to a beneficiary of past, unlawful aid to keep benefitting from those aid whereas they should repay them. The practice so far, based on Deggendorf case law, was that a firm that is subject to outstanding recovery order cannot receive any new aid. The flexibility introduced by para. 10 is watering it down and would reduce the incentive of beneficiaries to comply with recovery orders.
- Ensure differentiation of the CO_2 emission factor. By keeping it all equal, we are going to subsidize auto-generators for the opportunity cost of not selling their power to the grid. For example, refiners burn flue gasses on site, and use that to generate electricity to supply the plant - we would then be subsidizing them for the indirect costs from that generation.The guidelines assume no GHG emissions occur from

[1] See some examples of possible alternative to "compensation" measures to be considered by decision making bodies, with the example of coal power plants https://beyond-coal.eu/solving-the-coal-puzzle

renewable combustion or do not factor in other fuel mix, further it is limited only to electricity generation and not to other forms of energy generation (mechanical/heat) nor energy conservation measures

- The CO2 factors should not be based solely on emission intensive electricity generation - but take the full and rapidly declining carbon content of energy mixes across the EU into account. For example, last year, coal generation fell by 24% in the EU, leading to a 12% fall in European power sector CO2 emissions in 2019 alone – the biggest fall since at least 1990 (Sandbag and Agora Energiewende, 2020)[2]
- Other negative externalities, such as health damage costs due to other air pollution or environmental externalities are not discounted from the “compensation” schemes. The European Commission should subtract in all cases the externalised damage costs incurred by applying by default the value of statistical life (VSL) damage costs for air pollution, adapted to current price level and aligned to the OECD recommendations, where applicable. Those external costs are often passed on to public budgets or citizens, which is contrary to the polluter pays principle. Further not considering those externalities would provide a wrong assessment of the common assessment principle of “common interest” (para 15, 45) and eligibility criteria of “best value for money” (para 42)
- There is some confusion between the proposal and the explanatory note on the electricity consumption efficiency and fall back benchmarks and how they should be updated. At the very minimum, they should be set in a similar way as the benchmarks for free allocation - using the average of the 10% most efficient EU installations and with annual improvement rates to be applied. As a minimum, compliance with most ambitious “Union standards” (e.g. environmental performance levels that go beyond the level set for new plants within the EU Best Available Techniques standards) as well as compatibility with relevant Environmental Quality Standards objectives is to be expected for any eligible project
- The estimates for EUA prices should be replaced by actual EUA prices rather than averages of forward prices. If actual output levels can be used, why not actual price levels?
- Para. 11 and 12 is a welcome step forward. The change of definitions from baseline output and baseline electricity consumption to “actual output” and “actual electricity consumption”, especially in combination with paragraph 25 on repaying overcompensation

Compatibility assessment

- Para. 19: the alleged environmental objective is very indirect compared to the direct objective of preserving industries competitiveness. As mentioned above, there is a clear lack of evidence that EU climate policy triggers carbon leakage and current compensation levels lack focus and proportionality. Conversely the ETS guidelines do

[2] https://www.agora-energiewende.de/fileadmin2/Projekte/2019/Jahresauswertung_EU_2019/172_A-EW_EU-Annual-Report-2019_Web.pdf

not incentivise energy intensive operators from reducing their electricity consumption

- The common assessment principle of “common interest” (para 15, 45) and eligibility criteria of “best value for money” (para 42) is welcome. However, the common interest or best value for money criteria cannot be limited to climate aspects only and should integrate the wider zero pollution ambition for a circular economy goal set within the European Green Deal. A decision tree should be established to ensure that those criteria of “serving a common interest” and “best value for money” are indeed met when assessing the legitimacy and proportionality of the proposed support scheme. This means that any project shall be compatible with wider environmental protection objectives (e.g. compliance promotion towards Environmental Quality Standards such as air quality, resource efficiency, circular economy). That assessment should not be limited to aid or compensation schemes. Financial aid is one of the means to deliver a certain outcome, competent authorities should first be required to assess other policy options to achieve a certain change of behaviour of economic actors prior to considering “corrective” compensation aid schemes to certain economic actors, in most cases the high polluting ones
- Para. 24 and 40 requiring verification that the aid has an incentive effect, and removing the former presumption, are very welcome. However para. 24 should provide that payment of the aid can only incur the following year (and not the current year), based on the actual electricity consumption (that is defined in (12) as being determined ex post in t+1) to still expose the energy intensive operators to electricity/carbon prices and incentivise them to reduce their consumption. Assurance of receiving the aid the following year should suffice to incentivise them not to relocate
- Para. 32 on cumulation of aid is concerning. The positive language (“aid may be cumulated”) contrasts with previous negative language adopted in all other guidelines. Whilst it may have the same consequences, this new language signals to the energy intensive operators that they can cumulate a series of exemptions and compensations, which is not welcome in principle. This is particularly problematic for (b) cumulation of aid for the same eligible costs “partly or fully overlapping” and “any state aid without identifiable eligible costs”. The main concern is the possibility (or appearance thereof due to current wording) to get state aid for making the investments that fall under the conditionality clause (section 5). Although we welcome the principle of a conditionality and some of the eligible investments proposed in section 5, the conditionality clause must be effective. Authorising aid for making those investments (under the EEAG mainly) would result in giving the conditionality for free. The energy intensive operators can already make those investments under the EEAG so the environmental objectives pursued by para. 54 could already be achieved

No extension of eligibility for indirect cost compensation

- State aid for indirect costs should not be allowed in order to keep the incentive for electro- intensive industry to switch to electricity with lower carbon emissions and avoid a distortion of the EU internal market. Innovation support could instead be directed towards industrial sectors with relatively high indirect costs to enable efficiency improvements or a switch to sustainable renewables.
- While the list of sectors deemed eligible through the quantitative assessment has been reduced, the door has been left open for another four sectors to be added through an intransparent black-box qualitative assessment. The qualitative assessment has not even been included in the draft guidelines, but solely referred to in the accompanying explanatory note. This qualitative assessment should not be further developed and implemented, but scrapped altogether.
- On the methodology (indirect emission intensity of at least 1 kgCO2/EUR + trade and carbon intensity factors)
- Include the Gross Value Added criteria in the quantitative assessment to limit the risk of overcompensation. If the impact on GVA of sectors is such a core issue, then it should be included as a core criteria for determining sectoral eligibility. Carbon Market Watch urges that the Commission sets the bar at at least 1.5% of GVA

Free allocation

- CAN Europe opposes inadequately targeted hand out of free pollution permits and supports a tiered approach which means a targeted multi-step approach reflecting actual risk of carbon leakage should be used to limit free allocation, including a pathway to move to 100% auctioning of emission allowances. This should lead to less emission allowances given away for free and these left-over free allowances should be cancelled, or auctioned for innovation support[3]
- Para.44 needs to be reviewed. It says that aid intensity shall not exceed 70% but the directive says: “Up to 70 % of the relevant costs of an investment may be supported using the free allocation, provided that the remaining costs are financed by private legal entities”. Financing form a private legal entity may entail state aid if there is state control behind. The ETS guidelines thus seem more restrictive (which is good) but some more thoughts are needed on this one

Evaluation

- The potential mid-term review of some key variables does not go far enough. The CO2 factors and the benchmarks should be updated annually and automatically. As

[3] See the CAN Europe position on the post-2020 ETS reform: http://www.caneurope.org/docman/emissions-trading-scheme/3029-can-europe-ets-reform-position-21-12-2016/file

mentioned above, the benchmarks should at least be improved annually in similar fashion as the benchmarks for free allocation

Conditionality (Chapter 5 in draft GL)

- Strong conditionality is critical, must not be watered down further and should actually be enhanced. The conditions placed on companies to receive state aid should be strengthened. The state aid granted should all be used for investments in energy efficiency, renewable energy production and consumption, and emission reductions. Furthermore, as state aid should be focused towards triggering additional clean investments, an additionality criteria is necessary
- Energy audits: Carrying an audit within the next 4 years (at para. 53) seems very late, especially if the audit then needs time to be implemented. Also the first sentence of para. 54 refers only to beneficiaries covered by the obligation to conduct an audit: what about the others (referred to in para. 53)? Wording should be amended to include them in the conditionality clause. Furthermore the audit should not be limited to energy aspects only, but take account of wider environmental footprint of the changes triggered through the aid
- The Guidelines should provide for a hierarchy or prioritisation instead of alternative investments. Energy efficiency should come first as reducing consumption is crucial. Concrete investments such as on-site RES generation or PPAs should prevail over vague (c). To ensure the “best value for money” criteria, it is paramount that a decision tree is set on minimal performance objectives to be achieved by the given project, which includes impact of the aid on wider environmental objectives (e.g. air quality, resource use, circular economy, substitution of toxic pollutants through the value chain)
- (b) refers to “carbon-free” PPAs and not RES PPAs. The limitation to reducing the “carbon footprint” and “electricity consumption” is counter-productive to the wider protection goals and the audit should be extended to cover the “environmental and human health footprint” as well as “resource consumption” so to achieve a more coherent and forward looking approach as to the qualitative extent of the common interest gains delivered by the beneficiary
- The common assessment principle of “common interest” (para 15, 45) and eligibility criteria of “best value for money” (para 42) is welcome. However, the common interest or best value for money criteria cannot be limited to climate aspects only and should integrate the wider zero pollution ambition for a circular economy goal set within the European Green Deal. A decision tree should be established to ensure that those criteria of “serving a common interest” and “best value for money” are indeed met when assessing the legitimacy and proportionality of the proposed support scheme. This means that any project shall be compatible with wider environmental protection objectives (e.g. compliance promotion towards Environmental Quality Standards such as air quality, resource efficiency, circular economy). This aspects should be part of the audit scheme
- Add “or” in (b) between “electricity needs” and “through a carbon-free PPAs” (otherwise it seems that PPAs apply only to on-site generation facilities)
- Add storage and demand response management in (b)

- Member States should also publicly report on how industry fulfilled these conditions to provide data on how the state aid is actually used by companies. This information shall be made actively available through open access and free of charge online databases

Reporting by companies and member states

- There needs to be a central EU website for all the reporting under section 7

Disruption to the internal market

- In general, differentiated state aid does lead to disruptions to the internal market. Wealthier Member States are leading a race to the bottom. The way to remedy this issue is to limit state aid as much as possible and apply strict harmonised conditions

EU ETS revenues

- Indirect cost compensation should be explicitly delinked from EU ETS auctioning revenues. The soft cap of 25% implies that state aid can count towards article 10(3) of the EU ETS Directive. However, it clearly does not fulfill the conditions under Article 10(3) of the EU ETS Directive - even when including the conditions placed on installations for indirect cost compensation. The state aid itself, as determined by the draft guidelines, will not be fully used to reduce emissions, develop renewable energy, push energy efficiency, or any other of the areas identified in Article 10 (3). The ETS revenues should be used to fund climate action, not subsidies for industry

Article 10C

- The Article 10c Derogation should explicitly exclude the possibility of fossil fuel generation capacity and infrastructure receiving state aid
- The need to stop providing public funding to any upgrading, retrofitting, modernisation of infrastructure using or producing fossil or peat fuels or life extension (possible under article 10c). This exclusion also relates to fuel switching in Large Combustion Plants or renewable fuels if the resulting environmental performance does not achieve performance beyond the strict BAT-AE(P)L set for "new" plants or to new fossil gas plants (possible under articles 10c and 10d). Fossil fuel phase-out across Europe is essential to achieve a -55% emission reduction by 2030 and should not be delayed through public funding
- The aid under Article 10C should in no case finance the incremental improvement in emissions reduction: only significant reductions in emissions should be eligible and as above, in no case should fossil fuel generation receive aid. The transition to climate neutrality and zero pollution ambition requires the phasing out of all fossil fuels from the power sector and from most, if not all other applications. Important

co-benefits for air quality are achieved by replacing the thermal power (combustion) capacity, in particular when solid fuels are used. Investment in fossil fuels, including the 'incremental improvement' of the emission- performance of existing installations raises the overall costs of a transition by blocking investments which would allow regions to 'leap-forward' towards full climate neutrality. It also reinforces the lock-in of fossil fuel infrastructure, representing therefore a mis-use of public funds

Phasing out indirect cost compensations

- Indirect cost compensation is undermining the effectiveness of the EU ETS. The ETS mechanism is, theoretically, an effective mechanism to transition from GHG intensive to renewable and climate neutral generation. The higher the ETS price, the fewer hours the most polluting and inefficient forms of electricity production will run. However, clean energy alternatives need to be in place for this to have an effect. Without these alternatives, the most polluting plants continue to generate electricity and the largest electricity consumers, who will still be able to compensate the additional costs, will not have an incentive to procure clean electricity. Compensation of indirect costs removes carbon price signals
    - To avoid sudden economic impacts of the change in the guidelines and allow a transition period for industries to adapt their procurement procedures (and eventually finance renewable energy projects), one could suggest the following changes: The end of any indirect compensations by 2025, except for renewable energy contracts. These can be removed, from the moment trade agreements on standards are introduced
- Suggest the end of indirect compensations for bilateral contracts with coal and gas power plants by 2023. Energy-intensive industries should not be able to compensate the CO2 costs of bilateral electricity contracts (note: the industries are always free to celebrate contract electricity with low carbon intensity producers. These long term contracts provide fixed revenues for coal and gas power plants, extending thereby their lifetime. On the other hand, a similar compensation for renewable energy and fossil fuel sources of energy, as suggested in the current version of the guidelines, creates a de facto fossil fuel subsidy and an unfair situation in the market